STERLING RESOURCES
TSX:SLG
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MESSAGE TO SHAREHOLDERS

First Quarter 2011

As we began 2011, Sterling faced a number of challenges and opportunities. With a strengthened balance sheet following the close of the equity financing in December, we were in excellent shape to move forward with the Breagh Phase 1 development, to appraise Cladhan and to try to overcome political challenges in Romania.

At Breagh in the UK Southern North Sea, we began the year with a very successful appraisal well 42/13a-6 on the eastern side of the field which encountered 62 feet of gas bearing sand, the thickest to date. By proving up more reserves on the eastern side of the field, a second phase of development involving another platform is now considered very likely. During the first quarter, operations have been progressing to secure all contracts and permitting for the development of Breagh. A final draft of the Field Development Program (FDP) was submitted in mid June. The FDP is now expected to be approved around the end of June. All major contracts for the development have been awarded and the full-field project is on budget and on schedule to deliver first gas in July of 2012.

At Cladhan in the UK Northern North Sea, Sterling expanded its acreage in March 2011 by executing reciprocal agreements with Valiant Petroleum plc to facilitate the exchange of certain North Sea assets, resulting in the Company acquiring a 25 percent interest and operatorship of Blocks 210/29c and 210/30b immediately south and east of its current licenses. An appraisal well here is planned during 2012. During early April a successful sidetrack well 210/30a-4 was drilled one kilometer southeast of the 210/29a-4Y location, placing it further downdip in the northern core area. The well had a total measured depth of 12,252 feet and encountered two separate reservoir zones. No oil water contact was found and the main zone is in the same pressure regime as all other wells drilled in the northern core area. Consequently the effective minimum vertical oil column is now 1,228 feet.

Three geological sidetracks of the 210/30a-4 well were then drilled. The first sidetrack, 210/30a-4Z, located 1.6 kilometers east of the 210/30a-4 well, was completed during early May and targeted a portion of the fan system even further downdip. The 210/30a-4Z well was drilled to a measured depth of 15,900 feet and encountered two separate Upper Jurassic reservoir zones of 12 and 169 feet (vertical thickness) with oil shows through both. The well encountered these sands deeper than expected and much closer to a major fault system. Petrophysical analysis indicated porosities of up to 13.5 percent with a high degree of dolomitic cement and no pressure measurements were obtainable. While we would have preferred to see better quality sands in what appears to be a large package of oil filled reservoir, this is the first well into a deeper portion of the field with little well control. In our view this well may not be representative of the whole fan system and accordingly upside prospectivity in this area of the Cladhan field may still be significant. During May a sidetrack well 210/30a-4Y was drilled to a measured depth of 12,615 feet into a separate system to the south in the central channel. The well encountered 40 feet (vertical thickness) of high quality Upper Jurassic sands with porosities of up to 25 percent but the sands are water wet. Pressure measurements confirmed that the interval is over-pressured, but to a lesser extent than in the northern core area. The implication of this information is that the central channel is separate from the main reservoir in the northern core area. While we were disappointed to encounter wet sands, we were encouraged by the quality of the reservoir which positively aids our understanding of reservoir quality distribution within the Cladhan field.

In early June the fourth and final well of this Cladhan campaign, 210/30a-4X, was drilled into the most southern limit of the northern core area in a potentially separate channel to a measured depth of 10,614 feet, encountering 105 feet net (vertical thickness) of high quality Upper Jurassic sands. Petrophysical analysis of the interval showed five feet of oil-bearing sands at the top of the interval and the well will be suspended for possible re-use as a future development well at this location or elsewhere after a sidetrack. With the completion of the four well program, RPS Energy will start a review of the Cladhan resources with the intent of issuing an update report within a few weeks. The next drilling campaign at Cladhan is anticipated to commence in early 2012 following the integration of the data from this campaign into a field-wide reprocessed seismic project.

The Company is currently considering various development scenarios for Cladhan of either a subsea development system or a dedicated floating production storage and offloading unit with first production targeted as early as 2014.

During late March the UK Government increased North Sea taxation unexpectedly in the spring budget, raising the supplemental rate from 20 to 32 percent. This tax increase will impact Sterling to a much lesser degree than many of our peers because of our significant tax pools. Dialogue with the UK Government through the industry body Oil and Gas UK continues in an effort to ameliorate the impact on future investments in the North Sea and potentially exempt gas production from this tax increase.

In the Southern North Sea on Block 48/28b, a commitment well was drilled to 6,148 feet measured depth encountering good Leman sandstone but was unfortunately not hydrocarbon bearing. The well has been abandoned.

In the Paris Basin of France, Sterling as operator has been awarded 9.5 blocks pending final approval by the Secretary of State. A recent moratorium on fracking operations has delayed activity of our neighbours in their plans to evaluate the unconventional oil potential of the Liassic shale. We understand that a conclusion of the French government review will be to relax the control of drilling operations but that fracking activities will in future be scrutinised and monitored. Sterling will continue to monitor this situation and participate in industry dialogue with the government as deemed appropriate. No drilling is planned by Sterling until 2012 in the Paris Basin, although a multi-well drilling program is planned for this year on an adjacent license and its outcome will assist us in developing our own drilling plans going forward.

Subsequent to the end of the first quarter we announced that we had declared force majeure on Sterling's Midia and Pelican Blocks in the Romanian Black Sea, as the Company has been unable to undertake petroleum operations for reasons outside of its control which the Company views as political in nature. The total lack of clarity on the applicable procedure and authority for issuance of construction permits constitutes an event of force majeure under the Concession Agreement. One effect of this action will be that the duration of the license periods will be extended for the period in which we are under force majeure. Additionally, in early May Sterling filed a Notice of Default with NAMR as a result of NAMR's failure to grant license assignments to Sterling's partners Petro Ventures Europe BV and Gas Plus International BV for a 20 and 15 percent license holding respectively on its Midia and Pelican Blocks.

Having had no prompt resolution to these issues, Sterling filed a Notice of Dispute with the Government of Romania under the treaty for the Promotion and Reciprocal Protection of Investments between Romania and Canada (the "Treaty") on June 20, 2011. In the Treaty, Romania undertook obligations with respect to the protection of investments of Canadian investors into Romania. The Notice of Dispute allows for a 6 month period of negotiations in which to resolve the issues amicably. If Sterling is unable to obtain satisfactory resolution on all the issues within this period, the Company can then submit the matter to arbitration, if it so desires. Under the arbitration process, Sterling would claim monetary damages that reflect the entire and significant ultimate value of its offshore assets.

It is with much reluctance that the Company has had to take these steps in our efforts to continue the exploration and development of oil and gas resources in our offshore license blocks. We have always been of the opinion that Romania's Black Sea offers the country the potential to reduce gas imports dramatically, provide for high levels of investment and tax receipts while providing significant employment opportunities. Sterling has until recently been the only non-Romanian operator to have achieved exploration success in the offshore arena. This success has, we believe, had a knock-on effect in encouraging other companies, including majors, to take offshore licenses with potentially significant future benefit for the country. Sterling intends to be at the forefront of creating the infrastructure and business development to help realize this great potential for Romania. Our actions now are focused on taking a proactive approach in assisting in the resolution of the current impasse. As a long-standing, loyal and patient investor in the country we continue to reiterate that our intention is to follow through on our business activities and we remain optimistic that, with prompt actions from the government, an amicable resolution can be reached without resorting to arbitration.

For the first quarter of 2011, the Company adopted the International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (IASB). In the past, the Company had prepared its financial statements in accordance with previously applicable Canadian GAAP. The impact of the adoption of IFRS is evident in the financial results for the quarter and details regarding the newly adopted policies and reconciliation to previous GAAP are contained in Notes 2 through 21 inclusive of the interim consolidated financial statements.

In April Robin Clarkson joined us as Head of Legal and General Council. Robin has been involved with Sterling for a number of years as a Partner of the Aberdeen law firm Paull & Williamsons LLP. He has a wealth of international legal and contractual experience which further enhances the strength of our management team.

To conclude, in spite of certain technical and political challenges, the inherent strength of Sterling's attractive asset base remains and the Company's plans for growth are further underpinned by an experienced and committed team focused on maximizing value. We thank you our shareholders for your continued support as we move forward on these challenges, seeking to maximize the value of our assets.

On Behalf of the Board of Directors,

Mike Azancot
President and Chief Executive Officer
June 22, 2011

MANAGEMENT'S DISCUSSION AND ANALYSIS

This management's discussion and analysis (MD&A) of the operating results and financial condition of Sterling Resources Ltd. ("Sterling" or the "Company") for the three months ended March 31, 2011 is dated June 22, 2011 and should be read in conjunction with Sterling's unaudited condensed consolidated financial statements and accompanying notes as at and for the three months ended March 31, 2011 prepared in accordance with International Financial Reporting Standards ("IFRS"), representing generally accepted accounting principles for publicly accountable enterprises in Canada and the audited consolidated financial statements for the year ended December 31, 2010, prepared in accordance with Canadian Generally Accepted Accounting Principles at that time ("previous GAAP").

The unaudited interim condensed consolidated financial statements of the Company have been prepared in accordance with International Accounting Standard ("IAS") – *34 Interim Financial Reporting* – and IFRS 1 – *First-time Adoption of International Financial Reporting Standards* – as issued by the International Accounting Standards Board. The Company adopted IFRS on January 1, 2011 with a transition date of January 1, 2010 (the "Transition Date"). Previously, the Company prepared its interim consolidated financial statements in accordance with previous GAAP. The Company has provided IFRS accounting policies and prepared reconciliations between previous GAAP and IFRS in Note 3 and 21 of its March 31, 2011 condensed interim consolidated financial statements.

Corporate Overview and Strategy

Sterling is a publicly-traded, international energy company engaged in the acquisition of petroleum and natural gas rights, and the exploration for, and the development and production of, crude oil and natural gas. The Company operates primarily in the United Kingdom, Romania, the Netherlands and France, and is headquartered in Calgary, Alberta.

The Company's primary strategy for achieving growth is to source and initiate international projects with the potential to yield large, low-cost reserves. It concentrates on accumulating, exploring and exploiting licenses and prospects in selected core areas of the world. Sterling's strategy also targets blocks with high initial working interests where possible. Financial exposure and technical risk are managed by obtaining partner participation through farm-out and other arrangements. Under these arrangements, a portion of the Company's interest is given up in exchange for the partner paying a share of the costs of exploration, appraisal or development of the license. A secondary strategy is to acquire interests in discoveries where the Company believes that its technical and operational expertise can accelerate development, especially where there are multiple development candidates or significant exploration prospectivity nearby.

Forward-Looking Statements and Business Risks

Certain statements contained in this MD&A are forward-looking statements. These statements relate to future events or the Company's future performance. All statements other than statements of historical fact may be forward-looking statements. In some cases, forward-looking statements can be identified by terminology such as "may", "will", "should", "expect", "plan", "anticipate", "believe", "estimate", "predict", "potential", "continue", or the negative of these terms or other comparable terminology. In addition, statements relating to reserves or resources are deemed to be forward-looking statements as they involve the implied assessment, based on certain estimates and assumptions that the reserves and resources described can be profitably produced in future.

Forward-looking statements in this MD&A include, but are not limited to, statements with respect to:

- Commodity prices;
- The Company's expectations regarding the duration of the economic recovery from the world-wide recession of 2008-2009;
- Expectations regarding the Company's cost structure;
- Factors upon which the Company will decide whether or not to undertake a specific course of action;

- The Company's expectations regarding interest rates and inflation;
- The Company's expectations regarding its ability to raise capital or bank debt and the currency of any such capital or bank debt;
- The sale, farming-in, farming-out or development of certain exploration properties;
- The realization of anticipated benefits of acquisitions and dispositions;
- The Company's expectations regarding the possible impact of changes in government policy with respect to onshore and offshore drilling;
- The Company's expectations regarding its ability to obtain certain government and regulatory approvals;
- The Company's expectations regarding tax treatment under foreign government taxation regimes;
- The Company's expectations regarding its cash requirements and funding for the next year;
- The Company's drilling plans;
- The Company's tax horizon;
- The Company's corporate strategies, the criteria to be considered in connection therewith and the benefits to be derived therefrom;
- The Company's expectations regarding government policies with respect to concerns about climate change and the protection of the environment;
- The Company's plans and expectations that are described on page 13 under "2011 Plans"; and
- The Company's expectations regarding the effect of the transition to IFRS on its consolidated financial statements.

These statements are only predictions. Actual events or results may differ materially. In addition, this MD&A may contain forward-looking statements attributed to third-party industry sources, which sources are not endorsed or adopted by Sterling expressly or implicitly.

Undue reliance should not be placed on these forward-looking statements, as there can be no assurance that the plans, intentions or expectations upon which they are based will occur. By its nature, forward-looking information involves numerous assumptions, known and unknown risks and uncertainties, general and specific, that contribute to the possibility that the predictions, forecasts, projections and other forward-looking statements will prove inaccurate. Certain of these risks are beyond the Company's control, including: political instability in the countries in which it operates, the impact of general economic conditions in the areas in which it operates, civil unrest, industry conditions, changes in laws and regulations including the adoption of new environmental laws and regulations and changes in how they are interpreted and enforced, increased competition, the lack of availability of qualified personnel or management, fluctuations in commodity prices, foreign exchange or interest rates, stock market volatility and obtaining required approvals of regulatory authorities. In addition there are risks and uncertainties associated with oil and natural gas operations. Readers should also carefully consider the matters discussed "Risk Factors" beginning on page 17 of the Company's Annual Information Form.

With respect to forward-looking statements in this MD&A the Company has assumed, among other things, that the Company:

- Operates in an environment of fiscal and political stability;
- Operates in an environment of increasing competition;
- Is able to obtain additional financing or farm-out additional interests on satisfactory terms;
- Is able to continue to attract and retain qualified personnel; and
- Is able to obtain necessary approvals from partners for a particular course of action.

Although the Company believes that the expectations reflected in the forward-looking statements are reasonable, there can be no assurance that such expectations will prove to be correct. The Company cannot guarantee future results, levels of activity, performance, or achievements. Moreover it does not assume any obligation to update forward–looking statements except as required by law.

Actual results and future plans could differ materially from those anticipated in similar forward-looking statements in this MD&A as a result of the risks described above. These statements speak only as of the date of this MD&A.

The forward-looking statements contained in this MD&A are expressly qualified by the foregoing cautionary statement. Financial outlook information contained in this MD&A about prospective results of operations, financial position or cash flows is based on assumptions about future events, including economic conditions and proposed courses of action, based on management's assessment of the relevant information currently available. Readers are cautioned that such financial outlook information contained in this MD&A should not be used for purposes other than for which it is disclosed herein.

Transition to International Financial Reporting Standards (IFRS)

The Company's unaudited interim consolidated financial statements for the three months ended March 31, 2011 are its first financial statements prepared in accordance with IAS 34, using accounting policies consistent with IFRS, and accordingly the Transition Date to IFRS has been determined as January 1, 2010 in order to fully reflect the impact of the Company's new accounting policies on the comparative period for 2010. The Company had previously made reference to a Transition Date of January 1, 2008 in order to support its application for listing on the London Stock Exchange which requires 3 years of comparative financial statements prepared under IFRS. Delays in submission of this application beyond publication of these first quarter results for 2011 have resulted in a requirement to revert to a Transition Date of January 1, 2010. This later Transition date will not however affect the Company's ability to list in London.

The accounting policies applied in the preparation of the Company's unaudited interim condensed consolidated financial statements for the three months ended March 31, 2011, the comparative information for the three months ended March 31, 2010, and the opening IFRS balance sheet as at the Transition Date are described in Note 3 to the consolidated financial statements. Note 21 to the unaudited interim condensed consolidated financial statements contains a detailed description of the Company's adoption of IFRS, including a reconciliation of the consolidated financial statements previously prepared under previous GAAP to those under IFRS.

The Company has applied transitional provisions of IFRS on a retroactive basis and has elected not to apply certain exemptions permitted. The following is a summary of the cumulative impact on shareholders' equity of the key adjustments resulting from the application of IFRS:

	Note	As at January 1, 2010 (date of transition)	As at March 31, 2010	As at December 31, 2010
		$000's	$000's	$000's
Total equity under previous GAAP		208,131	193,828	319,383
Adjustments:				
Dry hole costs	(a)	(7,036)	(8,726)	(13,504)
Pre-license costs and other costs expensed under IFRS	(b)	(31,772)	(33,413)	(39,954)
Foreign currency impact of change in functional currencies	(c)	(11,470)	(5,816)	(3,580)
Capitalized stock compensation expensed under IFRS	(d)	(1,410)	(1,658)	(3,177)
Total equity under IFRS		156,443	144,215	259,168

a. Exploration and Evaluation Assets

The Company previously followed the full cost method of accounting for oil and gas assets. Under this method, all expenditures incurred in connection with the acquisition, exploration, appraisal and development of oil and gas assets were capitalized in cost centers on a country-by-country basis. As permitted under IFRS the Company has changed its policy to a successful efforts based accounting policy on a retroactive basis. Under this policy the costs of unsuccessful wells are expensed in the income statement in the period in which they are determined to be unsuccessful.

Application of this policy under IFRS has resulted in a reduction of assets of $7,036,000 as at transition due to the write-off of unsuccessful wells. In addition $1,690,000 and $6,468,000 was expensed in the first three months of 2010 and for the year ended December 31, 2010, respectively.

b. Pre-license Acquisition Costs and Indirect Overhead Charges

Under previous GAAP all costs associated with property acquisition, exploration and development activities were capitalized within a cost centre, including costs incurred prior to the acquisition of a mineral right. In addition all administrative and general overhead costs were capitalized to cost centers.

IFRS 6 only applies to activities undertaken after the acquisition of the legal rights to explore and therefore does not apply to pre-exploration costs. As these costs do not meet the definition of an asset they are expensed. In addition only directly attributable general and overhead costs have been capitalized to petroleum and natural gas assets.

As at transition date there is a charge of $31,772,000 to retained earnings due to the expensing of pre-license acquisition and other indirect overhead costs. For the three months ended March 31, 2010 there is a charge of $1,641,000 to the income statement. For the year ended December 31, 2010 there is a charge of $8,182,000 to the income statement.

c. Functional currency and Foreign Operations

IFRS requires that the functional currency of each entity of the Company be determined separately in accordance with IAS 21 – Foreign exchange and should be measured using the currency of the primary economic environment in which they operate ("the functional currency"). IFRS provides IFRS indicators that are used to assist in assessing the functional currency of the entity. Under previous GAAP, foreign currency translation is determined based upon the relationship between the parent company and the respective operating division – i.e. if they are financially or operationally interdependent with the reporting entity. Based upon this, the UK was determined to be the functional currency for all entities under previous GAAP.

Using the IFRS indicators, the functional currency for the entities differ from the functional currency determined under previous GAAP. When considering these indicators a change of functional currency for Sterling Resources Ltd. and for its Romanian operations was determined necessary. In particular:

Sterling Resources Ltd. - Since the entity exists to provide the companies access to the Canadian markets and the Canadian dollar influences the labour, material and other costs of providing goods and services, the Canadian dollar has been assessed as being the functional currency.

Romanian Operations - The US dollar mainly influences labour, material and other costs of providing goods and services for the Company's Romanian operations and therefore has been determined to be the functional currency of this entity under IFRS.

As at transition date, the change in functional currencies for the entities has resulted in a decrease in exploration and evaluation assets of $11,458,000, a decrease in property, plant and equipment of $12,000 with an offsetting decrease to foreign currency revaluation reserve as at transition date. In addition an adjustment to accumulated other comprehensive loss in the amount of $19,001,000 also resulted as at Transition Date.

For the year ended December 31, 2010 the change in functional currencies resulted in a decrease in exploration and evaluation assets of $3,572,000, a decrease in property, plant and equipment of $8,000 with an offsetting decrease to foreign currency revaluation reserve. In addition an adjustment to accumulated other comprehensive loss in the amount of $17,347,000 also resulted.

d. Share-Based Compensation

Under previous GAAP the proportion of share-based compensation attributable to exploration and development activities was capitalized within a cost centre. With the adoption of a successful efforts approach under IFRS, much of the share-based compensation previously capitalized would not be permitted as it relates to pre-license activity or unsuccessful wells. Accordingly, the Company has elected to follow the practise of many other companies, and not to capitalize share-based compensation.

A number of new standards and amendments to standards and interpretations are not yet effective for the year ended December 31, 2011 and have not been applied in preparing these consolidated financial statements. None of these are expected to have a significant effect on the consolidated financial statements of the Company, except for:

		Effective for periods commencing
IFRS 9	Financial instruments: Recognition and measurement	1 January 2013
	Improvements to IFRSs (issued May 2010)	Various

The above standards and interpretations are expected to be adopted in accordance with their effective dates and have not been adopted in these financial statements.

Significant Estimates

Management is required to make judgments, assumptions and estimates in the application of IFRS that have a significant impact on the financial results of the Company. Significant estimates in the financial statements include amounts recorded for the provision for future asset retirement obligations, share-based compensation expense and capital expenditure accruals. In addition, the Company uses estimates for numerous variables in the assessment of its assets for impairment purposes, including oil and natural gas prices, exchange rates, cost estimates and production profiles. By their nature, all of these estimates are subject to measurement uncertainty and the effect on future consolidated financial statements from changes in such estimates could be significant.

Operating Highlights

	Three Months Ended March 31	
	2011	2010
$000's except per share information		
Operating loss	**22,399**	1,185
Net financing (income) and expense	**(7)**	361
Net loss	**22,392**	1,546
Per common share		
– basic and diluted	**$0.12**	$0.01
Exploration and evaluation asset additions	**46,817**	1,871

	As at March 31, 2011	As At December 31, 2010
$000's except share information and acreage		
Net working capital	**75,075**	138,410
Total assets, end of period	**316,066**	270,316
Share capital, end of period	**294,965**	290,444
Net license acreage (000's of acres)	**2,577**	2,618
Common shares outstanding 000's – basic, end of period	**190,401**	188,944

For the three months ended March 31, 2011, the Company recorded a net loss of $22,392,000 ($0.12 per share) compared with a net loss of $1,546,000 ($0.01 per share) for the three months ended March 31, 2010. The increase in the loss is comprised of the following key elements:

Dry Hole Expense

During the first quarter of 2011, the Company expensed dry hole costs of $9,733,000 relating to the unsuccessful Grian exploration well on Block 48/28b (Sterling 57%) in the UK Southern North Sea. This total included $2,926,000 of preliminary costs incurred in 2010. In the same period of 2010, dry hole costs of $1,690,000 related to the unsuccessful Airidh exploration well on Block 42/19a (Sterling 30%) in the greater Breagh area of the UK Southern North Sea.

Pre-License and Other Exploration Costs

For the first quarter of 2011 pre-license and other exploration costs totalled $4,914,000 including $2,419,000 relating to the Netherlands and other international ventures, $1,470,000 relating to Romania and $1,025,000 relating to the Company's interest in its various licenses offshore the UK. In the same period in 2010, pre-license and other exploration costs totalled $1,641,000 comprised of $949,000 relating to Romania, $19,000 relating to other international ventures and $673,000 relating to UK licenses.

Employee Benefits Expense

Employee benefits expense of $2,253,000 for the first quarter of 2011 has increased by $1,044,000 over the quarter ended March 31, 2010. $913,000 of this increase is attributable to the increase in non-cash share based compensation expense due to share options issued to the new management team as well as options issued to other employees as part of the annual award program. Further increases of $784,000 relate to inflationary salary increases and the expansion of the management team and hiring of other new employees as the Company's role as an operator in the UK North Sea and internationally expands. Offsetting the impact of these increases is a reduction of $653,000 in the Company's provision for interest and penalties relating to the Company's stock option plan for UK employees.

Foreign Exchange

The Company's cash balances are maintained in the currencies in which they are expected to be utilized. Foreign exchange losses of $4,449,000 for the first quarter of 2011 arose mainly on translation of US dollar cash balances into the respective functional currencies of the operations holding the funds. During the first quarter, the US dollar weakened from par with the Canadian Dollar to US$1.00=C$0.9725, and from US$1.00=£0.6465 to US$1.00=£0.6237.

The foreign exchange gains of $4,212,000 in the first quarter of 2010 arise similarly on translation of funds into functional currency. During this period, the US dollar weakened from US$1.00=C$0.9532 to US$1.00=C$0.9815 against the Canadian dollar, but the loss on translation was more than offset by the impact of the US dollar strengthening against the UK pound from US$1.00=£0.6279 to US$1.00=£0.6637.

General and Administrative Expense

General and administrative expense of $1,025,000 for the first quarter of 2011 has increased from $838,000 in the same quarter of 2010, due to expansion of UK operations and the opening of a new office in the Netherlands.

Financing Costs

Financing costs include interest expense, amortization of debt issue costs and accretion of the discount on decommissioning obligations. Total costs have declined from $526,000 in the first quarter of 2010 to $83,000 in 2011 as a result of final repayment in April of 2010 of the Company's outstanding bridging facility.

Income Taxes

The Company does not recognize the tax benefit of losses incurred at this time as it has neither significant current production nor regulatory approval for the development of the Breagh or Cladhan fields offshore UK, or for the Doina/Ana field in the Black Sea offshore Romania. Consequently there is no assurance the tax benefit will be realized. As at March 31, 2011, the Company had estimated UK tax losses carried forward of approximately £149,000,000 and other capital allowances of $40,221,000 available to shield future taxable income in Canada, Romania and other international jurisdictions. These losses are not subject to expiry. In addition, the Company has approximately $23,611,000 of Canadian non-capital allowances which are subject to expiry over the next 20 years.

The Company is also required to incur eligible expenditures of approximately £57,000,000 as defined under present UK tax law within a period of three years in order to qualify for exemption from UK capital gains taxes associated with the gain on the disposition of a part interest in the greater Breagh area in August 2009. Of this amount approximately £28,000,000 of eligible expenditures have been incurred to March 31, 2011, and it is anticipated that with ongoing planned development expenditures for 2011 and 2012, total expenditures will be sufficient to ensure the Company qualifies for the full exemption.

Overview and Summary of Results for the Eight Most Recently Completed Quarters

The Company had no commercial production during the first quarter of 2011. Any minor pre-commercial production revenues during earlier quarters have been netted against related expenses, and the net amount capitalized as test production. Up to March 31, 2011 Sterling's results from operations were not affected by seasonal considerations. The following table summarizes the Company's income statements for the eight most recently completed quarters ended March 31, 2011. Quarters previous to the Company's Transition Date to IFRS of January 1, 2010 are reported under previous GAAP.

	IFRS					Previous GAAP		
	2011	2010				2009		
Quarter Ended	**Mar 31**	Dec 31	Sep 30	Jun 30	Mar 31	Dec 31	Sep 30	Jun 30
$000's except per share information								
Net (loss) profit before income taxes:								
Canada	**(2,955)**	926	(1,694)	(857)	(1,690)	(1,619)	(438)	(1,275)
United Kingdom	**(13,875)**	(4,859)	(6,804)	(2,843)	1,367	818	70,773	(226)
Romania	**(2,994)**	(974)	(873)	(1,809)	(1,203)	251	(581)	(162)
Other International	**(2,568)**	(1,020)	(865)	(476)	(20)	(1)	4	(6)
Net (loss) profit	**(22,392)**	(5,927)	(10,236)	(5,985)	(1,546)	(551)	69,758	(1,669)
(Loss) profit per common share								
Basic	**(0.12)**	(0.04)	(0.07)	(0.04)	(0.01)	–	0.53	(0.01)
Diluted	**(0.12)**	(0.04)	(0.07)	(0.04)	(0.01)	–	0.53	(0.01)

Under the Company's IFRS accounting policy for exploration and appraisal activity, its results from quarter to quarter are significantly impacted by the level and success of its drilling program.

Exploration and Evaluation Activity

During the first quarter of 2011 key operational activity and expenditures included the following:

- Ongoing construction work totalling $32,843,000 on the Breagh platform jacket, topsides, pipeline sections and onshore facilities;
- The successful East Breagh appraisal well 42/13a-6 costing $5,732,000. The success of the well means that a second phase of Breagh development involving a second platform is now very likely, with the well being tied back to the second platform as a producer;
- On Cladhan, the first well in a multi-well appraisal program was spudded in March 2011. Pre-development work on the field has commenced with the objective of working towards project sanction in 2013 and first production in 2014. Total costs incurred at Cladhan were $10,732,000;
- The unsuccessful operated Grian 48/28b-1 well, costing $6,807,000; and
- Ongoing development of the Kirkleatham gas project onshore UK at a cost of $434,000. Kirkleatham was brought on stream in the second quarter of 2011.

During the quarter the Company relinquished its interest in blocks 42/2b, 42/3 and 42/4 in the UK Southern North Sea.

In the first quarter of 2010, petroleum and natural gas expenditures totalled $3,561,000 comprised mostly of Breagh development costs, the costs relating to the unsuccessful Airidh well, and preliminary costs relating to the unsuccessful Grian well.

Financing Activities

During the quarter ended March 31, 2011, the Company's only cash financing activity was the issue of 1,457,000 common shares as a result of share options exercised by employees and directors under the Company's share option plan. The weighted average exercise price of the underlying options was $2.24 and aggregate proceeds were $3,266,000.

During the quarter ended March 31, 2010, the Company received proceeds of $1,162,000 from the exercise of 766,666 options at a weighted average price of $1.52, and additional proceeds of $34,000 from the exercise of 40,000 warrants. Other financing activity for the quarter included a scheduled repayment of a portion of the outstanding bridging facility of $3,733,000.

Negotiations on the senior secured loan facility to fund part of the costs of phase 1 of Breagh development continued during the quarter. The draft field development program ("FDP") for phase 1 was being revised to include some long-reach wells to access reserves in the eastern side of the field proved up by the 42/13a-6 well, which has led to further work on the loan model. The lending banks have resubmitted proposals to their credit committees and approval of a senior secured loan facility of approximately £100 million is expected around the end of the second quarter of 2011.

Financing, Liquidity and Solvency

Net Working Capital

$000's	**March 31, 2011**	December 31, 2010
Cash and cash equivalents	**96,948**	142,624
Restricted cash	**23,838**	963
Trade and other receivables	**5,908**	4,095
Prepaid expenses	**127**	62
Trade and other payables	**(50,499)**	(7,434)
Provisions	**(1,247)**	(1,900)
	75,075	138,410

Trade and other receivables of $5,908,000 at March 31, 2011 have increased from year-end 2010 levels mainly due to the increase in operational activity at Cladhan and Grian in the UK North Sea. Included in this total are non-trade UK and Romanian VAT receivables. Trade receivables totalled $3,928,000 (December 31, 2010 – $2,989,000) which are aged as follows:

$000's	Total	< 30 Days	30 – 60 Days	60 – 90 Days	90 – 120 Days	>120 Days
As at March 31, 2011	**3,928**	**1,643**	**744**	**1,461**	**80**	**–**
As at December 31, 2010	2,989	2,007	888	45	49	–

As at March 31, 2010, only minor trade receivables are greater than 90 days. Non-trade VAT receivables include $427,000 due from the Government of Romania which was significantly overdue at March 31, 2011 and December 31, 2010. The majority of this amount was received in the second quarter of 2011.

Cash and cash equivalents at March 31, 2011 include term deposits of $95,782,000 (December 31, 2010 – $139,238,000). Certain of these term deposits have maturities greater than 30 days from inception, but have cashable options and are therefore considered cash equivalents by management. The decrease in cash and cash equivalents over balances at December 31, 2010 is due mainly to capital expenditures on Cladhan, Grian, East Breagh and Breagh development as discussed above.

Restricted cash of $23,838,000 at March 31, 2011 ($963,000 as at December 31, 2010) comprised cash held in escrow which was available only for payment of expenditures included in accounts payable relating to the ongoing drilling program.

Trade and other payables of $50,499,000 at March 31, 2011 comprised mainly of expenditures related to the 2011 exploration drilling program and to accrued development expenditures relating to the Breagh project. The increase over the $7,434,000 as at December 31, 2010 is indicative of the ramping up of activity during the quarter.

Provisions of $1,247,000 at March 31, 2011 have been reduced from $1,900,000 at December 31, 2010. This provision was set up in 2010 to provide for an underpayment of employment taxes, associated interest and possible penalties relating to the Company's share option plan for UK employees. In the first quarter of 2011, certain affected individuals were determined to be non-resident, and therefore unaffected by the UK regulations.

Commitments and Contingencies

Excluding amounts held in escrow and shown as restricted cash for the Cladhan drilling program, as at March 31, 2011 commitments for the remainder of 2011 and years up to 2015 are comprised of the following:

	2011	2012	2013	2014	2015	Total
$000's						
Oil and gas drilling	–	8,781	14,343	–	–	23,124
Seismic	319	2,391	–	–	–	2,710
License fees	1,801	2,961	4,354	5,747	7,140	22,003
Other operating	44	44	44	33	1,721	1,886
Office and other leases	390	75	43	–	–	508
	2,554	14,252	18,784	5,780	8,861	50,231

Subsequent to December 31, 2010 the Company executed reciprocal agreements to facilitate the exchange of certain North Sea assets. As part of these arrangements the Company incurred an additional commitment of approximately $4,000,000 to drill a well on the subject blocks.

In addition to these commitments, the Company will also be required to incur eligible expenditures of approximately £57,000,000 as defined under present UK tax law within a period of three years in order to qualify for exemption from UK capital gains taxes associated with the gain on the disposition of a part interest in the greater Breagh area. Of this amount £28,000,000 of eligible expenditures have been incurred to March 31, 2011, and it is anticipated that with other planned development and exploration expenditures for 2011 and 2012, total expenditures will be sufficient to ensure the Company qualifies for the full exemption.

On April 28, 2011 following protracted discussions with the Romanian authorities, the Company invoked the force majeure provisions of its Concession Agreement for the Midia and Pelican Blocks in the Black Sea on the premise that it was unable to undertake petroleum operations for reasons outside of its control. One impact of the force majeure provisions will be to extend the duration of the Concession Agreement. On May 2, 2011 the Company filed a Notice of Default with the Romanian National Agency of Mineral Resources for failure to grant license assignments to its partners. Failure to resolve this problem would put the parties into a dispute resolution procedure which could ultimately result in international arbitration. The Company remains confident in its legal position with respect to these proceedings and accordingly has made no provision for impairment in its March 31, 2011 financial statements.

On June 20, 2011 the Company filed a Notice of Dispute with the Government of Romania under the bi-lateral Treaty for the Promotion and Reciprocal Protection of Investments between Romania and Canada. As recent specific measures launched by the Company including the declaration of force majeure and the issuance of a Notice of Default have not resolved the issues, the Company had no choice but to take this action to promote dialogue for a resolution of the impasse over the next 6 months and, if necessary, to resort to international arbitration under the Treaty.

Decommissioning Obligations

The Company's decommissioning obligation results from net ownership interests in petroleum and natural gas exploration stage activity. The provision is the discounted present value of the estimated cost, using existing technology at current prices. The Company estimates the total undiscounted amount of cash flows required to settle its asset retirement obligations to be approximately $3,238,000 which will be incurred between 2012 and 2032. Risk free interest rates and an inflation rate of 4 percent were used to calculate the fair value of asset retirement obligations. Revisions to estimates relate primarily to the extension of anticipated field lives as a result of the respective drilling programs.

	Three Months Ended March 31	
	2011	2010
$000's		
At beginning of period	**1,814**	2,199
Arising during period	**78**	–
Revisions to estimates	**50**	–
Foreign exchange differences	**49**	(132)
Accretion of discount	**83**	49
At end of period	**2,074**	2,116

Liquidity and Solvency

As at March 31, 2011, the Company's net working capital totalled $75,075,000. This is considered sufficient to cover its obligations and commitments for the next year.

Additional funding will be required for Phase 2 of the Breagh development and for the development of Cladhan and Doina/Ana. The Company is continuing to negotiate a senior secured debt facility in relation to Phase 1 of the Breagh development with a group of banks and the facility agreement is expected to be signed around the end of the second quarter of 2011.

In addition to the proposed senior debt facility, the Company is considering other contingent financing options including farm-outs. Depending on future exploration and appraisal activity and the level of senior debt eventually obtained, however, further equity issuances may also be considered to finance a limited portion of the exploration program.

2011 Plans

The Company's plans for the remainder of the year remain largely unchanged from those outlined in the annual report for the year ended December 31, 2010. The key focus for the remainder of 2011 will be on obtaining field development approval for the Breagh field in the UK North Sea, further appraisal of the Cladhan discovery and on moving forward with current initiatives in France, the Netherlands and offshore Romania.

In addition, Sterling specifically plans to:

- Install the Breagh jacket, topsides and pipeline for the first phase of development and drill the first three development wells in the western sector of the field;
- Work with the Operator to define Phase 2 of the Breagh development and to submit an addendum to the FDP to the government for approval;
- Complete the current multi-well appraisal program on the Cladhan field (finished in June, 2011), reprocess existing 3D seismic data and plan for the next drilling campaign in 2012;
- Subject to timely receipt of construction permits and resolution of other disputes, drill two exploration wells offshore Romania;
- Drill an appraisal well offshore the Netherlands;
- Continue geological and geophysical work on exploration prospects and discoveries on all its licenses; and
- Bring the Kirkleatham gas project on-stream in the second quarter of 2011 (which occurred on April 19, 2011).

These plans are contingent on partner approval and, more importantly, upon availability of suitable financing and (if appropriate) farm-out partners.

Corporately, in 2011 Sterling will also be focusing on completing the senior secured debt facility for funding development costs for the Phase 1 of the Breagh development (expected to be signed around the end of the second quarter of 2011), negotiating a step-up in the debt facility for the Phase 2 of the Breagh development, and working towards a listing on main board of the London Stock Exchange.

Additional information

Additional information about Sterling Resources Ltd. and its business activities, including Sterling's Annual Information Form, is available via SEDAR at www.sedar.com.

CONSOLIDATED BALANCE SHEETS

(Unaudited)	March 31, 2011 $000's	December 31, 2010 $000's	January 1, 2010 $000's
		[note 21]	[note 21]
ASSETS			
Current assets			
Cash and cash equivalents [note 5]	**96,948**	142,624	81,799
Restricted cash [note 6]	**23,838**	963	3,147
Trade and other receivables [note 7]	**5,908**	4,095	1,462
Prepaid expenses	**127**	62	53
	126,821	147,744	86,461
Non-current assets			
Exploration and evaluation assets [note 8]	**188,935**	122,359	85,799
Property, plant and equipment	**310**	213	168
	189,245	122,572	85,967
	316,066	270,316	172,428
EQUITY AND LIABILITIES			
Current liabilities			
Trade and other payables	**50,499**	7,434	6,105
Secured notes [note 9]	**–**	–	7,681
Provisions [note 10]	**1,247**	1,900	–
	51,746	9,334	13,786
Non-current liabilities			
Decommissioning obligations [note 10]	**2,074**	1,814	2,199
Commitments [note 11]	**–**	–	–
Equity			
Share capital [note 12]	**294,965**	290,444	157,643
Contributed surplus [note 12]	**9,510**	9,283	6,858
Accumulated other comprehensive loss [note 12]	**(9,434)**	(30,156)	(20,708)
Retained earnings (deficit)	**(32,795)**	(10,403)	12,650
	262,246	259,168	156,443
	316,066	270,316	172,428

The accompanying notes are an integral part of the interim condensed consolidated financial statements.

CONSOLIDATED INCOME STATEMENTS

Three Months Ended March 31	**2011**	2010
(Unaudited)	**$000s**	$000s
		[note 21]
Revenue	**–**	–
Expenses		
Dry hole expense	**9,733**	1,690
Pre-license and other exploration expenditures	**4,914**	1,641
Employee benefits expense [note 14]	**2,253**	1,209
Foreign exchange loss (gain)	**4,449**	(4,212)
General and administration	**1,025**	838
Depreciation	**25**	19
Total expenses	**22,399**	1,185
Operating loss	**22,399**	1,185
Financing income	**(90)**	(165)
Financing costs [note 15]	**83**	526
Net loss for the period	**22,392**	1,546
Net loss per common share [note 17]		
Basic	**0.12**	0.01
Diluted	**0.12**	0.01

The accompanying notes are an integral part of the interim condensed consolidated financial statements.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

Three Months Ended March 31	**2011**	2010
(Unaudited)	**$000s**	$000s
		[note 21]
Net loss	**22,392**	1,546
Foreign currency translation adjustment	**(20,722)**	12,178
Comprehensive loss	**1,670**	13,724

The accompanying notes are an integral part of the interim condensed consolidated financial statements.

CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY

(Unaudited)	Share Capital $000's	Contributed Surplus $000's	Accumulated Other Comprehensive Loss $000's	Retained Earnings (deficit) $000's	Total $000's
Balance at January 1, 2010 [note 21]	157,643	6,858	(20,708)	12,650	156,443
Exercise of stock options	1,162	–	–	–	1,162
Exercise of warrants	34	–	–	–	34
Transferred from contributed surplus on exercise of options	457	(457)	–	–	–
Share-based compensation	–	569	–	–	569
Foreign currency translation into presentation currency	–	–	(12,178)	–	(12,178)
Profit (loss) for the period	–	–	–	(1,546)	(1,546)
Balance at March 31, 2010 [note 21]	159,296	6,970	(32,886)	11,104	144,484
Balance at January 1, 2011	290,444	9,283	(30,156)	(10,403)	259,168
Exercise of stock options	3,266	–	–	–	3,266
Transferred from contributed surplus on exercise of options	1,255	(1,255)	–	–	–
Share-based compensation	–	1,482	–	–	1,482
Foreign currency translation into presentation currency	–	–	20,722	–	20,722
Profit (loss) for the period	–	–	–	(22,392)	(22,392)
Balance at March 31, 2011	**294,965**	**9,510**	**(9,434)**	**(32,795)**	**262,246**

The accompanying notes are an integral part of the interim condensed consolidated financial statements.

CONSOLIDATED STATEMENTS OF CASH FLOWS

Three Months Ended March 31	**2011**	2010
(Unaudited)	**$000s**	$000s
		[note 21]
Cash flows from operating activities		
Loss for the period	**(22,392)**	(1,546)
Adjustments to add (deduct) non-cash items		
Unrealized foreign exchange loss (gain)	**1,265**	(1,714)
Share based compensation [note 14]	**1,482**	569
Accretion [note 15]	**83**	49
Depreciation	**25**	19
Amortization of debt issue costs [note 15]	**–**	296
Financing expense	**–**	181
Financing income	**(90)**	(165)
Change in non-cash working capital	**40,534**	(66)
	20,907	(2,377)
Interest paid	**–**	(289)
Interest received	**90**	165
Net cash flows from (used in) operating activities	**20,997**	(2,501)
Cashflows from investing activities		
(Increase) decrease in restricted cash	**(22,875)**	(3,348)
Exploration and evaluation asset additions	**(46,817)**	(1,871)
Furniture and fixtures additions	**(123)**	(30)
Net cash flows used in investing activities	**(69,815)**	(5,249)
Cash flows from financing activities		
Repayment of secured notes	**–**	(3,733)
Proceeds from exercise of share options	**3,266**	1,162
Proceeds from exercise of warrants	**–**	34
Net cash flows used in financing activities	**3,266**	(2,537)
Effect of translation on foreign currency cash and cash equivalents	**(124)**	(5,679)
Decrease in cash and cash equivalents during the period	**(45,676)**	(15,966)
Cash and cash equivalents, beginning of period	**142,624**	81,799
Cash and cash equivalents, end of period	**96,948**	65,833

The accompanying notes are an integral part of the interim condensed consolidated financial statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

For the Three Months Ended March 31, 2011 and 2010

1. Corporate Information

Sterling Resources Ltd. (the "Company") is a publicly traded energy company incorporated and domiciled in Canada. The company is engaged in the exploration, appraisal and development of crude oil and natural gas in the United Kingdom, Romania, the Netherlands and France. The registered office is located at Suite 1450, 736 Sixth Avenue S.W. Calgary, Alberta Canada.

The Company's interim unaudited condensed consolidated financial statements comprise the financial statements of the Company and its 100% owned subsidiaries Sterling Resources (UK) Ltd. and Midia Resources SRL.

These interim unaudited condensed consolidated financial statements of the Company were approved for issue at a meeting of the Audit Committee on June 22, 2011.

2. Basis of Preparation

a. Statement of Compliance

These interim unaudited condensed consolidated financial statements have been prepared in accordance with International Accounting Standards (IAS) 34 – *Interim Financial Reporting,* and IFRS 1 – *First Time Adoption of International Financial Reporting Standards* as issued by the International Standards Board (IASB) and the *International Financial Reporting Interpretations Committee (IFRC).* Previously the Company prepared its consolidated annual financial statements in accordance with former Canadian Generally Accepted Accounting Principles ('previous GAAP').

These interim unaudited condensed consolidated financial statements have been prepared in accordance with IFRS standards and interpretations of IFRIC that are expected to be effective or available for adoption on December 31, 2011, the date of the Company's first annual reporting under IFRS. Accordingly the accounting policies for the annual period that are relevant to these interim condensed consolidated financial statements will be determined only when the first annual consolidated financial statements are prepared for the year ended December 31, 2011. An explanation of how the transition to IFRS has affected the reported financial position, financial performance and cashflows of the Company is provided in Note 21.

b. Basis of Consolidation

The interim unaudited condensed consolidated financial statements comprise the financial statements of the Company and its subsidiaries as at March 31, 2011. The financial statements of the subsidiaries are prepared for the same reporting period as the parent company, using consistent accounting policies.

Substantially all of the Company's exploration activities are conducted jointly with others, through farm-in and farm-out arrangements. Under these arrangements a portion of the Company's interest is given up in exchange for the partner paying a proportionate share of certain of the costs of drilling a well or other programs. The consolidated statements include the Company's proportionate share of the assets, liabilities, revenue and expenses with items of a similar nature presented on a line by line basis, from the date the joint arrangement commences until the joint arrangement ceases.

Inter-company balances and transactions, and any unrealized gains arising from inter-company transactions with its subsidiaries, are eliminated in preparing the consolidated financial statements.

c. Basis of Presentation

The interim unaudited condensed consolidated financial statements have been prepared on a going concern basis, under the historical cost convention.

d. Functional and Presentation Currency

These interim unaudited condensed consolidated financial statements are presented in Canadian dollars except when otherwise indicated. Each entity in the Company determines its own functional currency given the primary economic environment in which the entity operates. Under IFRS, the Canadian dollar is the functional currency for Canadian operations, the UK pound is the functional currency for UK operations and the U.S. dollar is the functional currency for Romanian operations. See Note 21 for a description of the impact of the change of functional currency on transition date and December 31, 2010.

e. Use of Accounting Assumptions, Estimates and Judgments

The preparation of the Company's interim condensed consolidated financial statements requires management to make judgments, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. The estimates and associated assumptions are based on historical experience and other factors that are considered to be relevant. Actual results may differ from these estimates.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimate is revised if the revision affects only that period or in the period of the revision and future periods if the revision affects both current and future periods.

Information about critical assumptions and estimation uncertainties considered by management in preparing the consolidated financial statements are described in the following notes:

Note 8 – Exploration and evaluation assets

Note 10 – Provisions

Note 11 – Commitments and contingencies

Note 14 – Share-based compensation

Note 16 – Income taxes

Information about critical judgments in applying accounting policies that have the most significant effect on the amounts recognized in these financial statements are the following:

Impairment Indicators

The Company monitors internal and external indicators of impairment relating to exploration and evaluation of assets. The assessment of impairment indicators inherently involves the exercise of judgment. If an impairment indicator exists then the recoverable amounts of the cash generating units and individual assets are determined based on the higher of value-in-use calculations and fair values less costs to sell. These calculations require the use of estimates and assumptions, such as future oil price assumptions.

Capital Commitments and Contingencies

By their nature contingencies will only be resolved when one or more future events occur or fail to occur. The assessment of contingencies inherently involves the exercise of significant judgement and estimates of the outcome of future events.

3. Significant Accounting Policies

The accounting policies described below have been applied consistently in these interim unaudited condensed consolidated financial statements and in preparing the opening IFRS balance sheet at January 1, 2010 for the purpose of the transition to IFRS, unless otherwise indicated. The accounting policies have been applied consistently by all Company entities.

a. Oil and Natural Gas Exploration, Evaluation and Development Expenditures

Oil and natural gas exploration and development expenditure is accounted for using the successful efforts method of accounting.

Pre-License and Other Exploration Expenditures

All pre-exploration expenditures and other exploration costs, including geological and geophysical costs and annual lease rentals, are charged to exploration expense when incurred.

Exploration and Evaluation Expenditures

During the geological and geophysical exploration phase, expenditures are charged against income as incurred. Once the legal right to explore has been acquired, expenditures directly associated with an exploration well are capitalized as exploration and evaluation intangible assets and are reviewed at each reporting date to confirm that there is no indication of impairment and that drilling is still underway or is planned. If no future exploration or development activity is planned in the license area the exploration license and leasehold property acquisition costs are written off.

Petroleum and Natural Gas Properties and Equipment

Once a project is approved for development, the carrying values of exploration license and leasehold property acquisition costs and associated costs with exploration wells are transferred to petroleum and natural gas properties and equipment. Further expenditures incurred after the commerciality of the field has been established, including the costs of drilling unsuccessful wells, are capitalized within petroleum and natural gas properties and equipment. Repairs and maintenance costs are charged as an expense when incurred.

Producing properties and significant unproved properties are assessed when events occur that indicate the carrying value of properties may not be recoverable from future cash flows. Any impairment loss is the difference between the carrying value of the asset and its fair value. Fair value is calculated as the present value of estimated expected future cash flows from proved, probable and, as appropriate, possible reserves.

Depletion

Depletion of capitalized development and production assets is calculated on a field or a concession basis as appropriate. The calculation is based on proved reserves using the unit of production method. Exploration and evaluation assets are not subject to depletion.

Decommissioning

Expected decommissioning costs of a property are provided for on the basis of the net present value of the liability, discounted at a pre-tax, risk-free rate. The costs are recorded as a liability with a corresponding increase in the carrying amount of the related asset and charged to the income statement along with the depreciation of the related asset. The liability is determined through a review of engineering studies, industry guidelines and management’s estimate on a site-by-site basis. The liability amount is increased each reporting period due to the passage of time and the amount is expensed during the period.

b. Impairment of Non-Financial Assets

Exploration and evaluation expenditures which are held as an intangible asset and development assets are reviewed at each reporting date for indicators of impairment at the level of cash generating units ("CGUs"). A CGU has been defined as a field, license area, or group of adjacent licenses. If impairment indicators exist then the assets or CGUs are tested for impairment. Any impairment is recognized in the income statement. Impairment tests are also carried out on any assets held for sale when a decision is made to sell such assets and as well before transferring assets to development and production assets following a declaration of commercial reserves.

Under oil industry standard practice impairment tests are calculated by comparing the net capitalized cost with the fair value less costs to sell the assets. This will be determined by the present value of future pre-tax cash flows which are expected to be derived from the license discounted at an appropriate annual discount rate.

c. Property, Plant and Equipment

Property, plant and equipment is carried at cost less accumulated depreciation and impairment losses, if any. Depreciation is calculated on a declining balance basis at an annual rate of 30 percent. The assets' residual values, useful lives and amortization methods are reviewed, and adjusted if appropriate, at each financial year end. An item of plant and equipment is derecognized upon disposal or when no further future economic benefits are expected from its use or disposal. Any gain or loss arising on derecognition (calculated as the difference between the net disposal proceeds and the carrying amount of the asset) is included in profit and loss in the year the asset is derecognized.

d. Cash and Cash Equivalents

Cash and cash equivalents include term deposits, guaranteed investment certificates and operating bank accounts with maturities from inception or cashable options, if applicable, of 90 days or less.

e. Restricted Cash

Restricted cash includes cash set aside for a specific use or future event.

f. Financial Assets

The Company initially recognizes financial assets within the scope of IAS 39 at fair value plus, in the case of investments not at fair value through profit or loss, directly attributable transaction costs. These assets are classified into one of the following categories, with subsequent measurement of the instruments based upon their classification.

Financial assets at fair value through profit or loss: A financial asset is classified at fair value through profit or loss if it is classified as held for trading or is designated as such upon initial recognition. They are measured at fair value with changes to those fair values recognized in finance income or finance costs in the income statement. Cash and cash equivalents and restricted cash are designated as "held-for-trading" and are measured at carrying value, which approximates fair value due to the short-term nature of these instruments. The Company has not designated any financial assets upon initial recognition as at fair value through profit and loss.

Loans and receivables: Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They are measured initially at fair value plus any directly attributable transaction costs. Subsequent to initial recognition loans and receivables are measured at amortized cost using the effective interest rate (EIR) method with any EIR amortization included in finance income in the income statement. Trade and other receivables are designated as "loans and receivables".

Held-to-maturity financial assets: If the Company has the intent and ability to hold debt securities to maturity, then such non-derivative financial assets are classified as held-to-maturity. They are measured at amortized cost using the EIR method. The Company did not have any held-to-maturity investments during the three months ended March 31, 2011 or the year ended December 31, 2010.

Available-for-sale Financial Assets: Available-for-sale assets include equity and debt securities. Equity securities classified as available-for-sale are non-derivative financial assets that are neither classified as held-for-trading nor designated as fair value through profit and loss. Debt securities in this category are those which are intended to be held for an indefinite period of time and which may be sold in response to needs for liquidity or in response to changes in the market conditions. These assets are measured at fair value with changes to fair value recognized in other comprehensive income, net of tax until the investment is derecognized, at which time the cumulative gain or loss is recognized in other operating income, or determined to be impaired, at which time the cumulative loss is reclassified to the income statements in finance costs and removed from the available-for-sale reserve. The Company did not have any available-for-sale investments during the three months ended March 31, 2011 or the year ended December 31, 2010.

The Company derecognizes a financial asset when the contractual rights to the cash flows from the asset expire, or it transfers the rights to receive the contractual cash flow of the financial asset in a transaction in which substantially all the risks and rewards of ownership of the financial asset are transferred.

The Company assesses at each reporting date whether there is any objective evidence that a financial asset or group of financial assets is impaired. A financial asset or group of financial assets is deemed to be impaired if, and only if, there is objective evidence of impairment as a result of one or more events that have occurred after the initial recognition of the asset and that loss event has an impact on the estimated future cash flows of the financial asset or the group of financial assets that can be reliably estimated.

g. Financial Liabilities

Financial liabilities within the scope of IAS 39 are recognized initially at fair value and in the case of loans and borrowings, plus directly attributable transaction costs. These liabilities are classified into one of the following categories, with subsequent measurement of the instruments based upon their classification.

Financial liabilities at fair value through profit or loss: Financial liabilities are classified as held-for-trading if they are acquired for the purpose of selling in the near term. Gains or losses on liabilities held-for-trading are recognized in the income statement. The Company has not designated any financial liabilities upon initial recognition as at fair value through profit or loss.

Loans and borrowings: After initial recognition, interest bearing loans and borrowings are subsequently measured at amortized cost using the effective interest rate method. Gains and losses are recognized in the income statement when the liabilities are derecognized as well as through the EIR method amortization process. Amortized cost is calculated by taking into account any discount or premium on acquisition and fee or costs that are an integral part of the EIR. The EIR amortization is included in finance cost in the income statement. The Company's financial liabilities include trade and other payables, and financial liabilities which are comprised of secured notes.

Financial guarantee contracts: Financial guarantee contracts are those contracts that require a payment to be made to reimburse the holder for a loss it incurs because the specified debtor fails to make a payment when due in accordance with the terms of the debt instrument. The Company did not hold guarantees during the three months ended March 31, 2011 or the year ended December 31, 2010.

A financial liability is derecognized when the obligation under the liability is discharged or cancelled or expires.

When an existing financial liability is replaced by another from the same lender on substantially different terms, or the terms of an existing liability are substantially modified, such an exchange or modification is treated as a derecognition of the original liability and the recognition of a new liability, and the difference in the respective carrying amounts is recognized in the income statement.

h. Offsetting of Financial Instruments

Financial assets and financial liabilities are offset and the net amount reported in the consolidated balance sheet if, and only if, there is a currently enforceable legal right to offset the recognized amounts and there is an intention to settle on a net basis, or to realize the assets and settle the liabilities simultaneously.

i. Derivative Financial Assets

The Company does not currently utilize derivative financial instruments, including hedging relationships.

j. Revenue

The Company recognizes revenue for petroleum and natural gas assets at the fair value of the consideration received or receivable when the significant risks and rewards of ownership are transferred to the buyer and it can be reliably measured and at such time as a project becomes commercially viable and development approval is received. Prior to this stage, any production is considered test production and related revenue is capitalized net of applicable costs.

k. Earnings Per Share

The Company presents basic and diluted earnings per share (EPS) data for its common shares. Basic EPS is calculated by dividing the net profit or loss attributable to common shareholders of the Company by the weighted average number of common shares outstanding during the period. Diluted EPS is determined by dividing the net profit or loss attributable to common shareholders by the weighted average number of common shares outstanding during the year, plus the weighted average number of common shares that would be issued on conversion of all dilutive potential common shares into common shares. Those potential common shares comprise convertible notes and share options granted.

l. Finance Income and Expense

Finance income comprises interest earned on funds on deposit.

Finance expense comprises accretion of the discount on decommissioning obligations, interest expense on borrowings and amortization of debt issue costs related to the secured notes.

Borrowing costs that are not directly attributable to the acquisition, construction or production of a qualifying asset are recognized in profit or loss using the effective interest method.

m. Foreign Currency Translation

Transactions and Balances

Transactions in foreign currencies are translated into the functional currency using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognized in the income statement.

Foreign Operations

Each entity in the group is measured using the currency of the primary economic environment in which the entity operates its functional currency. Foreign currency transactions are translated into functional currency using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognized in the income statement.

For the purpose of the consolidated financial statements, the results and financial position are reported in Canadian dollars, which is the presentation currency for the consolidated financial statements. On consolidation of subsidiaries with a non Canadian dollars presentation currency, balance sheets are translated into the Canadian dollars at the closing rate and income and expenses at the average monthly rate. All resulting exchange differences arising in the period are recognized in other comprehensive income. Such translation differences are reclassified to profit or loss in the period in which any such foreign operation is disposed of.

n. Income Taxes

The income tax expense represents the sum of the current income tax and deferred tax.

Current tax is provided at amounts expected to be paid (or recovered) using the tax rates and laws that have been enacted or substantively enacted by the balance sheet date.

Deferred tax is the tax expected to be payable or recoverable on differences between the carrying amounts of assets and liabilities in the financial statements and the corresponding tax bases used in the computation of taxable profit, and is accounted for using the balance sheet liability method. Deferred tax liabilities are generally recognized for all taxable temporary differences and deferred tax assets are recognized to the extent that it is probable that taxable profits will be available against which deductible temporary differences can be utilized. The carrying amount of deferred tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the asset to be recovered. Deferred tax is calculated at the tax rates that are expected to apply in the period when the liability is settled or the asset is realized. Deferred tax is charged or credited in the income statement, except when it relates to items charged or credited directly to equity, in which case the deferred tax is also dealt with in equity.

Because the Company has not yet received development approval from the regulatory authorities in the UK or Romania, however, full provision has been made against any future tax benefit relating to timing differences.

o. Share-Based Compensation

Under the Company's share option plan, options to purchase common shares are granted to directors, officers and employees at then current market prices. The cost of share option transactions which is considered to be the fair value of the option as determined using a Black-Scholes model, is recognized together with a corresponding increase in other capital reserves in equity, over the period in which the performance and/or service conditions are fulfilled. The cumulative expense recognized for share option transactions at each reporting date until the vesting date reflects the extent to which the vesting period has expired and the Company's best estimate of the number of options that will ultimately vest. The income statement expense or credit for a period represents the movement in cumulative expense recognized as at the beginning and end of that period and is recognized in employee benefits expense.

No expense is recognized for awards that do not ultimately vest, except for share option transactions where vesting is conditional upon a market or non-vesting condition, which are treated as vesting irrespective of whether or not the market or non-vesting condition is satisfied, provided that all other performance and/or service conditions are satisfied.

Where the terms of a share option transaction award are modified, the minimum expense recognized is the expense as if the terms had not been modified, if the original terms of the award are met. An additional expense is recognized for any modification that increases the total fair value of the share-based compensation transaction, or is otherwise beneficial to the employee as measured at the date of modification.

Where a share option award is cancelled, it is treated as if it vested on the date of cancellation, and any expense not yet recognized for the award is recognized immediately. This includes any award where non-vesting conditions within the control of either the entity or the employee are not met. However, if a new award is substituted for the cancelled award, and designated as a replacement award on the date that it is granted, the cancelled and new awards are treated as if they were a modification of the original award, as described in the previous paragraph. All cancellations of share option transaction awards are treated equally.

The dilutive effect of outstanding options is reflected as additional share dilution in the computation of diluted earnings per share.

p. Leases

The determination of whether an arrangement is, or contains, a lease is based on the substance of the arrangement assessing whether the fulfillment of the arrangement is dependent on the use of a specific asset or assets or the arrangement conveys a right to use the asset.

The classification of leases as finance or operating leases requires the Company to determine, based on an evaluation of the terms and conditions, whether it retains or acquires the significant risks and rewards or ownership of these assets and accordingly whether the lease requires an asset and liability to be recognised on the balance sheet.

The Company currently leases assets all which have been determined to be operating leases. Operating lease payments are recognized as an expense in the income statement on a straight line basis over the lease term. Finance charges are reflected in the income statement.

4. New Accounting Standards and Interpretations Not Yet Adopted

New standards and amendments to standards and interpretations are not yet effective for the year ended December 31, 2011 and have not been applied in preparing these interim unaudited condensed consolidated financial statements. None of these are expected to have a significant effect on the consolidated financial statements of the Company, except for:

		Effective for periods commencing
IFRS 9	Financial instruments: Recognition and measurement	1 January 2013
	Improvements to IFRSs (issued May 2010)	Various

The above standards and interpretations are expected to be adopted in accordance with their effective dates and have not been adopted in these financial statements.

5. Cash and Cash Equivalents

Cash and cash equivalents consist of the following:

	March 31, 2011	December 31, 2010	January 1, 2010
	$000's	$000's	$000's
Cash	**1,166**	3,386	4,547
Cash equivalents	**95,782**	139,238	77,252
	96,948	142,624	81,799
Balances held in:			
Canadian dollars	**5,259**	92,123	2,118
US dollars	**70,803**	35,994	72,276
UK pounds	**20,869**	14,445	7,392
Other	**17**	62	13
Cash and cash equivalents	**96,948**	142,624	81,799

Cash and cash equivalents comprise cash at banks and short-term deposits. As at March 31, 2011 cash equivalents carried interest rates between 0.03 percent and 1.0 percent (December 31, 2010 – 0.03 percent and 1.0 percent). The carrying amount of these assets is considered to be equal to their fair value.

6. Restricted Cash

Restricted cash of $23,838,000 as at March 31, 2011 was comprised of cash held in escrow accounts which was available only for payment of expenditures relating to the 2011 drilling program. As at December 31, 2010 and January 1, 2010, restricted cash of $963,000 and $3,147,000 respectively, was comprised of cash held in escrow accounts which was available only for payment of expenditures included in trade and other payables relating to certain drilling programs.

7. Financial Instruments

The Company's financial instruments, including cash and cash equivalents, restricted cash, trade and other receivables, secured notes and trade and other payables, approximate their carrying values. Financial instruments have been categorized as follows:

- Cash and cash equivalents and restricted cash – held-for-trading;
- Trade and other receivables – loans and receivables; and
- Secured notes and trade and other payables – other financial liabilities.

The fair value of a financial instrument is the amount of consideration that would be agreed upon in an arm's length transaction between knowledgeable, willing parties who are under no compulsion to act. The Company characterizes inputs used in determining fair value using a hierarchy that prioritizes inputs depending on the degree to which they are observable. All of the Company's cash and cash equivalents are fair valued using quoted prices in the active markets for identical assets as of the reporting date.

The Company is exposed to a number of different financial risks arising from normal course business exposures, as well as the Company's use of financial instruments. These risk factors include market risks relating to foreign exchange rate fluctuations and interest rate risk, as well as liquidity risk and credit risk.

Foreign Exchange Rate Risk

The Company's functional currencies for UK, Canadian and Romanian operations are the UK pound, Canadian dollar and US dollar respectively. Foreign exchange gains or losses can occur on translation of working capital denominated in currencies other than the functional currency of the jurisdiction which holds the working capital item. Excluding the impact of changes in the cross-rates, a one-percent fluctuation between translation rates would have the following impact on net income, based on foreign currency balances held at March 31, 2011.

	C$000's
Canadian dollar vs. UK pound	15
Canadian dollar vs. US dollar	148
UK pound vs. US dollar	1,004

Interest Rate Risk

As at March 31, 2011, the Company had no "interest bearing" debt which exposed its cash flows to interest rate risk. However, from time to time the Company may have significant cash or cash equivalent balances invested at prevailing short-term interest rates. Accordingly cash flows are sensitive to changes in interest rates on these investments. Based on total cash and cash equivalents and restricted cash at March 31, 2011, a one percent change in average interest rates would increase or decrease net income by approximately $1,208,000 over a full year.

Liquidity Risk

Liquidity risk is the risk that an entity will encounter difficulty in meeting obligations associated with financial liabilities. At present the Company has sufficient cash to settle its trade and other payables and meet its immediate joint venture commitments and license obligations. The Company monitors and manages its liquidity through comparisons of working capital with budgets and regular forecasts of cash requirements, and by adjusting discretionary expenditures where appropriate.

Credit Risk

Credit risk is the risk that a customer or counterparty will fail to perform an obligation or fail to pay amounts due causing a financial loss. The Company's trade and other receivables are primarily with governments for recoverable amounts of value added taxes (VAT) or joint venture partners in the oil and gas industry. Receivables from partners are secured by the partner's interest in the underlying oil and gas properties. This risk is therefore not considered significant. As at March 31, 2011 no provision has been made for impairment as all amounts have been subsequently collected or are secured by partner's interests.

8. Exploration and Evaluation Assets

	Three Months Ended March 31, 2011	Year Ended December 31, 2010
	$000's	$000's
Balance, beginning of period	**122,359**	85,799
Additions	**46,817**	40,295
Foreign exchange	**19,759**	(3,735)
Balance, end of period	**188,935**	122,359

In accordance with the Company's impairment policy, exploration and evaluation assets were reviewed for indicators of impairment at the reporting dates. Based upon these reviews, management determined that no impairment provision was needed.

9. Secured Notes

On April 20, 2009 the Company completed a US$11,200,000 bridge financing facility at an interest rate of 15 percent and commissions of 6 percent payable to the underwriters. Each unit of US$100,000 was repayable in three equal installments 6, 9 and 12 months from closing. Each unit also included one common share warrant entitling the holder to acquire 20,000 common shares of the Company at $0.84 per share. The notes were repaid in full on April 20, 2010. Following repayment and a period of ten consecutive trading days during which the Company's share price traded above $2.00 per share, the Company exercised its right to force conversion of the warrants.

	Three Months Ended March 31, 2011	Year Ended December 31, 2010
	$000's	$000's
Balance, beginning of period	**–**	7,681
Repayment of notes	**–**	(7,437)
Amortization of debt issue expenses	**–**	366
Foreign exchange	**–**	(610)
Balance, end of period	**–**	–

10. Provisions

The following is a continuity of provisions:

	Three Months Ended March 31, 2011			Year Ended December 31, 2010		
	Decommissioning	**Other**	**Total**	Decommissioning	Other	Total
	$000's	**$000's**	**$000's**	$000's	$000's	$000's
At beginning of period	**1,814**	**1,900**	**3,714**	2,199	–	2,199
Arising during period	**78**	**–**	**78**	–	1,900	1,900
Revisions to estimates	**50**	**(653)**	**(603)**	(337)	–	(337)
Disposals	**–**	**–**	**–**	–	–	–
Foreign exchange differences	**49**	**–**	**49**	(209)	–	(209)
Accretion of discount	**83**	**–**	**83**	161	–	161
At end of period	**2,074**	**1,247**	**3,321**	1,814	1,900	3,714

Decommissioning Obligations

The Company's decommissioning provision results from net ownership interests in petroleum and natural gas exploration stage activity. The provision is the discounted present value of the estimated cost, using existing technology at current prices. The Company estimates the total undiscounted amount of cash flows required to settle its asset retirement obligations to be approximately $3,238,000 which will be incurred between 2012 and 2032. A risk free interest rate and an inflation rate of 4 percent were used to calculate the fair value of asset retirement obligations.

Revisions to estimates relate primarily to the extension of anticipated field lives as a result of the respective drilling programs.

Other Provisions

Other provisions include a provision in the amount of $1,247,000 relating to the Company stock option plan for UK employees. The matter is currently under review and is expected to be resolved in the third quarter of 2011.

11. Commitments and Contingencies

Excluding amounts held in escrow, and shown as restricted cash, for the Cladhan drilling program, as at March 31, 2011, commitments for the remainder of 2011 and years up to 2015, are comprised of the following:

	2011	2012	2013	2014	2015	Total
	$000's	$000's	$000's	$000's	$000's	$000's
Oil and gas drilling	–	8,781	14,343	–	–	23,124
Seismic	319	2,391	–	–	–	2,710
License fees	1,801	2,961	4,354	5,747	7,140	22,003
Other operating	44	44	44	33	1,721	1,886
Office and other leases	390	75	43	–	–	508
	2,554	14,252	18,784	5,780	8,861	50,231

Subsequent to December 31, 2010 the Company executed reciprocal agreements to facilitate the exchange of certain North Sea assets. As part of these arrangements the Company incurred an additional commitment of approximately $4,000,000 to drill a well on the subject blocks.

In addition to these commitments, the Company will also be required to incur eligible expenditures of approximately £57,000,000 as defined under present UK tax law within a period of three years in order to qualify for exemption from UK capital gains taxes associated with the gain on the disposition of a part interest in the greater Breagh area. Of this amount £28,000,000 of eligible expenditures have been incurred to March 31, 2011, and it is anticipated that with other planned development and exploration expenditures for 2011 and 2012, total expenditures will be sufficient to ensure the Company qualifies for the full exemption.

On April 28, 2011 following protracted discussions with the Romanian authorities, the Company invoked the force majeure provisions of its Concession Agreement for the Midia and Pelican Blocks in the Black Sea on the premise that it was unable to undertake petroleum operations for reasons outside of its control. One impact of the force majeure provisions will be to extend the duration of the Concession Agreement. On May 2, 2011 the Company filed a Notice of Default with the Romanian National Agency of Mineral Resources for failure to grant license assignments to its partners. Failure to resolve this problem would put the parties into a dispute resolution procedure which could ultimately result in international arbitration. The Company remains confident in its legal position with respect to these proceedings and accordingly has made no provision for impairment in its December 31, 2010 financial statements.

On June 20, 2011 the Company filed a Notice of Dispute with the Government of Romania under the bi-lateral Treaty for the Promotion and Reciprocal Protection of Investments between Romania and Canada. As recent specific measures launched by the Company including the declaration of force majeure and the issuance of a Notice of Default have not resolved the issues, the Company had no choice but to take this action to promote dialogue for a resolution of the impasse over the next 6 months and, if necessary, to resort to international arbitration under the Treaty.

12. Share Capital and Reserves

Authorized share capital consists of an unlimited number of common shares without nominal or par value. The holders of common shares are entitled to one vote per share and are entitled to receive dividends as recommended by the Board of Directors.

Share capital issued and outstanding is as follows:

	Three Months Ended March 31, 2011		Year Ended December 31, 2010	
Continuity of common shares	**Shares 000's**	**Amount $000's**	Shares 000's	Amount $000's
Balance, beginning of period	**188,944**	**290,444**	132,175	157,126
Issued for cash:				
– public equity issuances	**–**	**–**	53,344	134,266
– exercise of stock options	**1,457**	**3,266**	2,045	3,325
– exercise of warrants	**–**	**–**	1,380	1,159
Share issue costs	**–**	**–**	–	(7,407)
Non-cash transfer from warrants	**–**	**–**	–	517
Transferred from contributed surplus on exercise of options	**–**	**1,255**	–	1,458
Balance, end of period	**190,401**	**294,965**	188,944	290,444
Continuity of warrants				
Balance, at beginning of period	**–**	**–**	1,380	517
Exercise of common share warrants	**–**	**–**	(1,380)	(517)
Balance, end of period	–	–	–	–
Share capital, end of period	**190,401**	**294,965**	188,944	290,444

On August 12, 2010, the Company completed a bought deal financing agreement with a syndicate of underwriters for the issue of 23,423,500 common shares at a price of $1.90 per share including an underwriters' over-allotment option of 2,368,500 common shares at the same price. The net proceeds of the issue of approximately $42,000,000, after fees and expenses, are intended to be used towards any required equity component of the financing of the Breagh project in the United Kingdom North Sea.

On December 22, 2010, the Company completed a bought deal financing agreement with a syndicate of underwriters for the issue of 29,920,500 common shares at a price of $3.00 per share including an underwriters' over-allotment option of 3,250,500 common shares at the same price. The net proceeds of the issue of approximately $85,000,000, after fees and expenses, are intended to be used towards the planned appraisal program on the Cladhan discovery in the first half of 2011, other exploration and appraisal activities in the United Kingdom, Romania, France and the Netherlands, initial pre-development work on the offshore Romania gas projects and for general corporate purposes.

Reserves

Contributed surplus: Contributed surplus is used to record the cost of equity-settled transactions over the period in which the performance and/or service conditions are fulfilled.

Accumulated other comprehensive income: This reserve is used to record exchange differences arising from the translation of the financial statements of foreign operations.

13. Segmented Information

The Company's operating segments are based on the internal reports provided to the Chief Operating Decision Maker, which has been identified as the Chief Executive Officer, to evaluate segment performance, decide how to allocate resources and make other operating decisions. The primary segment reporting format has been determined to be the geographical segments according to the location of the asset. The Company has one class of business, being the exploration for, and development and production of, oil and gas reserves.

There are four geographical reporting segments. Canada is the home of the head office. The United Kingdom, Romania and other international locations are involved in exploration and development operations. Other international comprises operations in France and Netherlands.

	Canada	United Kingdom	Romania	Other International	Consolidated
Segmented Results	$000's	$000's	$000's	$000's	$000's
Three months ended March 31, 2011					
Dry hole expense	**–**	**(9,733)**	**–**	**–**	**(9,733)**
Net loss before income tax	**(2,955)**	**(13,924)**	**(2,945)**	**(2,568)**	**(22,392)**
Three months ended March 31, 2010					
Dry hole expense	–	(1,690)	–	–	(1,690)
Net (loss) profit before income tax	(1,709)	1,386	(1,203)	(20)	(1,546)

	Canada	United Kingdom	Romania	Other International	Consolidated
Other Segmented Information	$000's	$000's	$000's	$000's	$000's
As at and for the period ended March 31, 2011					
Exploration and evaluation assets	**–**	**151,130**	**37,805**	**–**	**188,935**
Exploration and evaluation asset additions	**–**	**46,817**	**–**	**–**	**46,817**
As at and for the period ended March 31, 2010					
Exploration and evaluation assets	–	56,157	25,799	–	81,956
Exploration and evaluation asset additions	–	1,871	–	–	1,871

14. Share-Based Compensation

The Company has established a stock option plan whereby it may grant equity-settled options to its directors, officers, employees and consultants. On March 31, 2011 there were 13,304,000 (December 31, 2010 – 13,304,000) common shares reserved for issuance under the plan. The exercise price of each option equals the market price of the Company's shares on the date of the grant. The option's maximum term is five years, with the minimum vesting period to be 18 months. Stock options currently issued vest over the initial three years. There have been no cancellations or modifications to any of the plans during the period.

The following is a continuity of outstanding stock options:

Continuity of Common Share Options	Three Months Ended March 31, 2011 Options 000's	Three Months Ended March 31, 2011 Weighted Average Exercise Price Cdn $	Year Ended December 31, 2010 Options 000's	Year Ended December 31, 2010 Weighted Average Exercise Price Cdn $
Balance, beginning of period	**11,949**	**2.18**	8,627	1.90
Granted during the period	**350**	**4.25**	5,805	2.42
Exercised during the period	**(1,457)**	**2.24**	(2,045)	1.63
Expired during the period	**–**	**–**	(438)	2.45
Outstanding, end of period	**10,842**	**2.24**	11,949	2.18
Exercisable, end of period	**1,933**	**1.97**	3,390	2.09

The Black-Scholes option pricing model was used to calculate the fair value of the options using the following weighted average assumptions for options issued:

	Three Months Ended March 31, 2011	Year Ended December 31, 2010
Weighted average share price at grant date	**$4.25**	$2.18
Weighted average exercise price of options granted	**$4.25**	$2.18
Risk-free interest rate	**2.24%**	2.21%
Expected hold period to exercise	**3.5 years**	3.5 years
Volatility in the price of the Company's shares	**78.9%**	83.9%
Dividend yield	**0%**	0%

The expected volatility is based on the historical volatility of the Company's share price (calculated based on the weighted average remaining life of the share options, adjusted for any expected changes to future volatility due to publicly available information).

The weighted average fair value of options granted during the three months ended March 31, 2011 was $4.25 per share (2010 – $1.40 per share). For the three months ended March 31, 2011, $1,482,000 of share-based compensation was expensed (three months ended March 31, 2010, $569,000).

The following stock options were outstanding at March 31, 2011:

Exercise Price		Options Outstanding			Options Exercisable		
From $	To $	Options 000's	Remaining Contract Life (Days)	Weighted Average Exercise Price	Options 000's	Remaining Contract Life (Days)	Weighted Average Exercise Price
1.00	**1.49**	**2,513**	**838**	**1.42**	**630**	**428**	**1.42**
1.50	**1.99**	**1,083**	**911**	**1.80**	**408**	**404**	**1.57**
2.00	**2.49**	**2,672**	**1,094**	**2.05**	**142**	**61**	**2.45**
2.50	**2.99**	**3,124**	**836**	**2.60**	**753**	**318**	**2.56**
3.00	**3.50**	**1,100**	**1,332**	**3.33**	**–**	**–**	**–**
3.51	**4.25**	**350**	**1,438**	**4.25**	**–**	**–**	**–**
1.00	**3.50**	**10,842**	**977**	**2.24**	**1,933**	**353**	**1.97**

15. Financing Costs

Three Months Ended March 31	**2011**	2010
	$000's	$000's
Interest expense	**–**	181
Amortization of debt issue costs	**–**	296
Accretion [note 10]	**83**	49
Total financing costs	**83**	526

16.Income Taxes

Current Income Tax

No provision for current income tax is required due to availability of loss carry-forwards.

Deferred Tax

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts for income tax purposes. As at March 31, 2011, March 31, 2010 and December 31, 2010, the Company has recognized a full valuation allowance against a future income tax asset arising from tax pools in excess of the net book value of capital assets, share issue costs and non-capital losses.

17. Loss Per Share

The following reflects the loss and share data used in the basic and diluted earnings per share computations:

Three Months Ended March 31	**2011**	2010
	$000's except per share	$000's except per share
Weighted average shares outstanding	**189,161**	131,902
Dilution factor		
– Convertible notes	**–**	569
– Share options	**4,039**	363
Diluted shares outstanding (see note)	**189,161**	131,902
Net loss	**22,392**	1,546
Net loss per share		
– Basic	**0.12**	0.01
– Diluted	**0.12**	0.01

There have been no other transactions involving ordinary shares or potential ordinary shares between the reporting date and the completion of these financial statements. As at March 31, 2011 and 2010, the dilutive effect of the Company's outstanding options was not included in diluted shares outstanding due to the net loss incurred during the periods.

18. Assets Held for Sale

During 2010, the Company sold certain of its UK onshore properties for net proceeds of $554,000. Under the Company's accounting policy for petroleum and natural gas properties and equipment no gain or loss resulted from the sale.

19. Related Party Transactions

Subsidiaries

These unaudited condensed consolidated financial statements include the financial statements of Sterling Resources Ltd. and its subsidiaries. Sterling Resources Ltd. is the ultimate parent. The following companies have been consolidated within the Company's financial statements:

Name of Subsidiary	Country of Incorporation	Country of Operation	% Equity Interest
Sterling Resources (UK) Ltd.	United Kingdom	United Kingdom	100%
Midia Resources SRL	Romania	Romania, France	100%

Balances and transactions between the Company and its subsidiaries, which are related parties of the Company, have been eliminated on consolidation.

20. Subsequent Events

There are no post balance sheet events which require disclosure.

21. Transition to International Financial Reporting Standards

As stated in Note 2, these are the Company's first interim unaudited condensed consolidated financial statements prepared in accordance with IAS 34, using accounting policies consistent with IFRS.

The accounting policies in Note 3 have been applied in preparing these interim unaudited condensed consolidated financial statements for the three months ended March 31, 2011, the comparative information for the three months ended March 31, 2010, the consolidated financial statements as at and for the year ended December 31, 2010 and the opening IFRS balance sheet as at January 1, 2010, the "Transition Date".

In preparing the opening IFRS balance sheet and the financial statements for the year ended December 31, 2010 and for the three months ended March 31, 2010 the Company has adjusted amounts reported previously in financial statements prepared in accordance with previous GAAP.

This note explains the principal adjustments made by the Company in restating its previous GAAP balance sheet as at January 1, 2010 and its previously published GAAP financial statements.

Exemptions Applied

The Company followed the provisions of IFRS 1, *First-Time Adoption of International Financial Reporting Standards* in preparing its opening IFRS balance sheet. As required by IFRS 1, adjustments were recognized directly through retained earnings (or another category of equity where appropriate) in accordance with the general rules of IFRS 1 which is to apply IFRS retrospectively. IFRS 1 allows first-time adopters certain elections from the retrospective application of certain IFRS standards as at transition date. The Company has not adopted any of the elective exemptions and has retrospectively applied IFRS to previous periods.

Restatement of Equity from Previous GAAP to IFRS

IFRS employs a conceptual framework that is similar to previous GAAP. However, significant differences exist in certain matters of recognition, measurement and disclosure. While adoption of IFRS has not changed the Company's actual cash flows, it has resulted in changes to the Company's reported balance sheet and income statement. In order to provide the users of the financial statements with an understanding of these changes, the Company's previous GAAP balance sheet as at March 31 2010, December 31, 2010, and as at Transition Date and the income statement and statement of comprehensive income for the three months ended March 31, 2010 and year ended December 31, 2010 have been reconciled to IFRS, with the resulting differences explained below.

a. Exploration and Evaluation Assets

The Company previously followed the full cost method of accounting for oil and gas assets. Under this method, all expenditures incurred in connection with the acquisition, exploration, appraisal and development of oil and gas assets were capitalized in cost centers on a country-by-country basis. As permitted under IFRS the Company has changed its policy to a successful efforts based accounting policy on a retroactive basis. Under this policy the costs of unsuccessful wells are expensed in the income statement in the period in which they are determined to be unsuccessful.

Application of this policy under IFRS has resulted in a reduction of assets of $7,036,000 as at transition due to the write-off of unsuccessful wells. In addition $1,690,000 and $6,468,000 was expensed in the first three months of 2010 and for the year ended December 31, 2010, respectively.

b. Functional Currency and Foreign Operations

IFRS requires that the functional currency of each entity of the Company be determined separately in accordance with IAS 21 – *Foreign exchange* and should be measured using the currency of the primary economic environment in which they operate ("the functional currency"). IFRS provides IFRS indicators that are used to assist in assessing the functional currency of the entity. Under previous GAAP, foreign currency translation is determined based upon the relationship between the parent company and the respective operating division – i.e. if they are financially or operationally interdependent with the reporting entity. Based upon this, the UK pound was determined to be the functional currency for all entities under previous GAAP.

Using the IFRS indicators, the functional currency for the entities differ from the functional currency determined under previous GAAP. When considering these indicators a change of functional currency for Sterling Resources Ltd. and for its Romanian operations was determined necessary. In particular:

Sterling Resources Ltd. – Since the entity exists to provide access to the Canadian markets and the Canadian dollar influences the labour, material and other costs of providing goods and services, the Canadian dollar has been assessed as being the functional currency.

Romanian Operations – The US dollar mainly influences material and other exploration and evaluation costs and services for the Company's Romanian operations and therefore has been determined to be the functional currency of this entity under IFRS.

As at Transition Date, the change in functional currencies for the entities has resulted in a decrease in exploration and evaluation assets of $11,458,000, a decrease in property, plant and equipment of $12,000 with an offsetting decrease to accumulated other comprehensive loss as at Transition Date. In addition an adjustment to accumulated other comprehensive loss in the amount of $19,001,000 also resulted as at Transition Date.

For the year ended December 31, 2010 the change in functional currencies resulted in a decrease in exploration and evaluation assets of $3,572,000, a decrease in property, plant and equipment of $8,000 with an offsetting decrease to accumulated other comprehensive loss. In addition an adjustment to accumulated other comprehensive loss in the amount of $17,347,000 also resulted.

c. Pre-License Acquisition and Other Exploration Costs

Under previous GAAP all costs associated with property acquisition, exploration and development activities were capitalized within a cost centre, including costs incurred prior to the acquisition of a mineral right. In addition certain administrative and general overhead costs were capitalized to cost centers.

IFRS 6 only applies to activities undertaken after the acquisition of the legal rights to explore and therefore does not apply to pre-license costs. As these costs do not meet the definition of an asset they are expensed. In addition, only directly attributable general and overhead costs have been capitalized to exploration and evaluation assets.

As at Transition Date there is a charge of $33,182,000 to retained earnings due to the expensing of pre-license acquisition and other indirect overhead costs. For the three months ended March 31, 2010 there is a charge of $1,641,000 to the income statement. For the year ended December 31, 2010 there is a charge of $8,182,000 to the income statement.

d. Presentation

IFRS presentation differs from the presentation in accordance with previous GAAP. In particular:

i. In accordance with IFRS 6, *Exploration of Mineral Resources*, E&E assets are classified as either intangible or tangible assets according to their nature. Under previous GAAP these costs were classified as tangible assets within property, plant and equipment. The Company will be classifying E&E assets as intangible assets. Costs in the amount of $85,799,000 as at January 1, 2010 and $122,359,000 as at December 31, 2010 have been reclassified to intangible assets.

ii. In accordance with IAS 1, *Presentation of Financial Statements*, certain line items on the previous GAAP income statement have been reclassified. In particular:

(a) The netting of income and expenses is normally prohibited under IFRS. Therefore, for the three months ended March 31, 2010 finance income in the amount of $165,000 has been reclassified from the financing expense of $329,000. For the year ended December 31, 2010 the financing income in the amount of $218,000 was segregated from the finance expense.

(b) Employee salaries and benefits have been reclassified from "General and Administrative" expenses under previous GAAP and aggregated along with share-based compensation expense and included in "Employee Benefits" expense under IFRS. This resulted in $1,209,000 in the three months ended March 31, 2010 and $4,801,000 in the year ended December 31, 2010 being reclassified.

(c) Accretion relating to the decommissioning provision in the amount of $49,000 in the three months ended March 31, 2010 and $161,000 for the year ended December 31, 2010 has been reclassified and included in finance expenses.

Reconciliation of Assets, Liabilities and Equity

		January 1, 2010 (Date of Transition)			December 31, 2010		
	Note	Previous GAAP	Effect of Transition to IFRS	IFRS	Previous GAAP	Effect of Transition IFRS	IFRS
(Unaudited)		$000's	$000's	$000's	$000's	$000's	$000's
ASSETS							
Current assets							
Cash and cash equivalents		81,799	–	81,799	142,624	–	142,624
Restricted cash		3,147	–	3,147	963	–	963
Trade and other receivables		1,462	–	1,462	4,095	–	4,095
Prepaid expenses		53	–	53	62	–	62
		86,461	–	86,461	147,744	–	147,744
Non-current assets							
Exploration and evaluation assets	(d)-i	–	85,799	85,799	–	122,359	122,359
Petroleum and natural gas properties and equipment	(a), (b), (c), (d)-i	137,475	(137,475)	–	182,566	(182,566)	–
Property, plant and equipment	(b)	180	(12)	168	221	(8)	213
		137,655	(51,688)	85,967	182,787	(60,215)	122,572
		224,116	(51,688)	172,428	330,531	(60,215)	270,316
LIABILITIES AND EQUITY							
Current liabilities							
Trade and other payables		6,105	–	6,105	9,334	(1,900)	7,434
Secured notes		7,681	–	7,681	–	–	–
Provisions					–	1,900	1,900
		13,786	–	13,786	9,334	–	9,334
Non-current liabilities							
Decommissioning provision		2,199	–	2,199	1,814	–	1,814
Equity							
Share capital		157,643	–	157,643	290,444	–	290,444
Contributed surplus		6,858	–	6,858	9,283	–	9,283
Accumulated other comprehensive income (loss)	(b)	9,763	(30,471)	(20,708)	(9,229)	(20,927)	(30,156)
Retained earnings (deficit)	(a), (b), (c)	33,867	(21,217)	12,650	28,885	(39,288)	(10,403)
		208,131	(51,688)	156,443	319,383	(60,215)	259,168
		224,116	(51,688)	172,428	330,531	(60,215)	270,316

Reconciliation of Profit and Loss

		Three Months Ended March 31, 2010			Year Ended December 31, 2010		
	Note	Previous GAAP	Effect of Transition to IFRS	IFRS	Previous GAAP	Effect of Transition to IFRS	IFRS
(Unaudited)		$000's	$000's	$000's	$000's	$000's	$000's
Revenue		–	–	–	–	–	–
Expenses							
Dry hole expense	(a)	–	1,690	1,690	–	6,468	6,468
Pre-license and other exploration costs	(c)	–	1,641	1,641	–	8,182	8,182
General and administration	(d)-ii	1,530	(692)	838	6,602	(1,008)	5,594
Employee benefits expense	(d)-ii	–	1,209	1,209	–	4,801	4,801
Foreign exchange (gain) loss	(b)	(3,495)	(717)	(4,212)	(4,332)	1,768	(2,564)
Share based compensation	(d)-ii	330	(330)	–	2,148	(2,148)	–
Accretion	(d)-ii	52	(52)	–	164	(164)	–
Depreciation	(b)	20	(1)	19	89	(1)	88
Total Expenses		(1,563)	2,748	1,185	4,671	(17,898)	22,569
Financing income	(d)-ii	–	(165)	(165)	–	(218)	(218)
Financing costs	(d)-ii	329	197	526	311	391	702
Net profit (loss) for the period		1,234	(2,780)	(1,546)	(4,982)	(18,071)	(23,053)

Reconciliation of Comprehensive (Loss) Income

		Three Months Ended March 31, 2010			Year Ended December 31, 2010		
	Note	Previous GAAP	Effect of Transition to IFRS	IFRS	Previous GAAP	Effect of Transition to IFRS	IFRS
(Unaudited)		$000's	$000's	$000's	$000's	$000's	$000's
Net profit (loss) for the period		1,234	(2,780)	(1,546)	(4,982)	(18,071)	(23,053)
Foreign currency translation adjustment	(b)	(17,302)	5,124	(12,178)	(18,992)	9,544	(9,448)
Comprehensive loss		(16,068)	2,344	(13,724)	(23,974)	(8,527)	(32,501)

Reconciliation of Equity

	Note	As At January 1, 2010 (Date of Transition)	As At March 31, 2010	As At December 31, 2010
(Unaudited)		$000's	$000's	$000's
Total equity under previous GAAP		208,131	193,828	319,383
Adjustments:				
Pre-license costs and other costs expensed under IFRS	(c)	(31,772)	(33,413)	(39,954)
Capitalized stock compensation expensed under IFRS	(c)	(1,410)	(1,658)	(3,177)
Dry hole expense	(a)	(7,036)	(8,726)	(13,504)
Foreign currency impact of change in functional currencies		(11,470)	(5,816)	(3,580)
Total equity under IFRS		156,443	144,215	259,168

CORPORATE INFORMATION

Sterling Resources Ltd.

Directors

WALTER DEBONI (1) (5) (6)
Chair
Calgary, Canada

MICHAEL J. AZANCOT
Farnham, England

ROBERT B. CARTER (3) (4) (5)
Calgary, Canada

STEWART G. GIBSON (1)
Aboyne, Scotland

TECK SOON KONG (3) (5)
London, England

GRAEME G. PHIPPS (1) (2) (3)
St. Helier, Jersey

(1) Reserves Committee
(2) Chair Reserves Committee
(3) Audit Committee
(4) Chair Audit Committee
(5) Governance and Compensation Committee
(6) Chair Governance and Compensation Committee

Management

MICHAEL J. AZANCOT
President and Chief Executive Officer

MARK BEACOM
Vice President and General Manager Romania

DAVID M. BLEWDEN
Chief Financial Officer

STEPHEN BIRRELL
Vice President and General Manager Netherlands and France

ROBIN M. CLARKSON
Head of Legal and General Counsel

SHERRY L. CREMER
Treasurer and Corporate Secretary

DAVID A. FINDLATER
Vice President Exploration

GEORGE KESTEVEN
Manager, Corporate and Investor Relations

JOHN M. RAPACH
Chief Operating Officer

PATRICK WHITLEY
Vice President Exploration International

Corporate Headquarters

STERLING RESOURCES LTD.
Suite 1450, 736 Sixth Avenue S.W.
Calgary, Alberta, Canada T2P 3T7
Tel: 403-237-9256
Fax: 403-215-9279
E-Mail: info@sterling-resources.com
Website: www.sterling-resources.com

Investor Relations

GEORGE KESTEVEN
Tel: 403-215-9265
Fax: 403-215-9279
E-Mail: george.kesteven@sterling-resources.com

Auditors

ERNST & YOUNG LLP

Banker

THE ROYAL BANK OF CANADA

Legal Counsel

STIKEMAN ELLIOTT LLP
Calgary, Canada

Reserves Evaluators

RPS ENERGY
Henley-on-Thames, UK

Registrar and Transfer Agent

Inquiries regarding change of address, registered shareholdings, stock transfers or lost certificates should be directed to:

COMPUTERSHARE INVESTOR SERVICES INC.
9TH Floor, 100 University Avenue
Toronto, Ontario, Canada M5J 2Y1
Tel: 800-564-6253
Fax: 888-453-0330
416-263-9394
E-Mail: service@computershare.com

Stock Exchange Listing

THE TSX VENTURE EXCHANGE
Stock Exchange Trading Symbol: SLG

Sterling Resources (UK) Ltd. (Wholly Owned)

Directors

WALTER DEBONI
Chair
Calgary, Canada

MICHAEL J. AZANCOT
Farnham, England

TECK SOON KONG
London, England

DAVID MILLER
London, England

Management

MICHAEL J. AZANCOT
Managing Director

DAVID BLEWDEN
Chief Financial Officer

ROBIN M. CLARKSON
Head of Legal and General Counsel and Company Secretary

SHERRY L. CREMER
Assistant Company Secretary

DAVID A. FINDLATER
Vice President Exploration and Business Development

JOHN M. RAPACH
Chief Operating Officer

CHRISTINE SHINNIE
Controller

PATRICK WHITLEY
Vice President Exploration International

United Kingdom Offices

Banchory Business Centre
Burn O'Bennie Road
Banchory, Aberdeenshire
Scotland AB31 5ZU
Tel: 44-13308-26717
Fax: 44-13308-20670

78 Pall Mall
London
England SW1Y 5ES
Tel: 44-203-0088-488

Banker

BANK OF SCOTLAND

ROYAL BANK OF SCOTLAND

Legal Counsel

PAULL & WILLIAMSONS
Aberdeen, Scotland

PROINVEST CONSULT SRL
Bucharest, Romania

Midia Resources S.R.L.

Romanian Office

Str Andrei Muresanu Poet 11-13
Etaj 1, Apt 2
Sector 1
Bucharest 011841
Romania

MARK BEACOM
Vice President and General Manager
Romania

Tel: 40-212-313256
Fax: 40-212-313312

Sterling Resources Netherlands B.V.

Netherlands Office

J.P. Coenstraat 7
2595 WP, The Hague
Netherlands

STEPHEN BIRRELL
Vice President and General Manager
Netherlands and France

Tel: 31-70-7999163
Fax: 31-70-7999370

Annual General and Special Meeting

May 19, 2011, 10:00 a.m.
The Plaza Room, Metropolitan Conference Centre
333 – 4th Avenue S.W.
Calgary, Alberta, Canada